ence for the first three policy years. Because buydown loans are often offered through builders, there is strong suspicion that the property value may include the cost of the buydown arrangement, reducing real net equity.

The sharp drop in buydown instruments during the fourth policy year can be attributed to the fact that most of these instruments are limited to buydowns of up to three years. Therefore, most of the buydowns have reached level payment status by the fourth year. Graduated payment mortgages present not only payment shock, but also built-in negative amortization for the first several years of the loan. Most of the insured GPMs reached level payment status by the sixth or seventh year, and this explains the drop in claim frequency at that time.

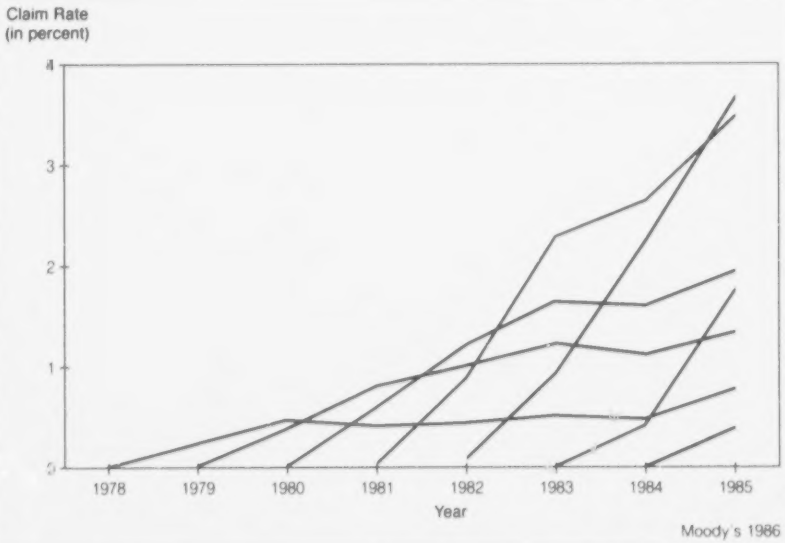
The remaining charts depict claim frequencies by four loan-to-value groupings in four major loan types during the past six to eight years, depending on the instrument type. Note the differences in claim-rate scale between loan types when making comparisons. Graph 5 depicts claim frequencies for fixed-rate, fixed-payment mortgages for 1978-1985. While the frequencies are generally lower than those depicted for all loans originated between 1978 and 1985, the shapes of curves are very close. Claim frequencies for later policy years are nearly equal because of the dominance of fixed-rate loans originated before 1982.

Graph 6 depicts claim rates on fully amortizing, adjustable rate mortgages. Compared with fixed-rate mortgages, the claim frequencies for all loan-to-value categories are higher. Also note that the claim frequencies jumped back up for most of the loan-to-value groups in the sixth policy year. Moody's attributes this to both continued low home price appreciation and heavier prepayments of loans in 1984, which contributed to adverse selection on the remaining book.

Graph 7 depicts claim frequencies on ARMs with potential or scheduled negative amortization. All loan-to-value groups show claim frequencies higher than fully amortizing ARMs. These loans have peaked in the fourth year on average. However, given the preponderance of 1981, 1982 and 1983 negative-amortization ARMs and the fact that foreclosure frequencies of loans originated in these years have yet to turn downward, there is the possibility that the average peak claim frequency on negative-amortizing ARMs may be longer than four years.

GRAPH 9

Claim Rates
Fixed-Rate Loans
Loan-to-Value > 91%
1978–1985



Moody's 1986

Claim rates on graduated payment mortgages by loan-to-value groups are depicted in Graph 8. Nearly all of the loan-to-value groups display a peak claim rate in the fifth policy year reflecting a relationship to the maximum number of scheduled payment increases and the degree of added negative amortization.

The final chart is intended to express Moody's concerns over the combined impact of continued low home price appreciation in many areas of the country and the recent decline in mortgage interest rates on refinancing and adverse selection. Mortgage interest rates have been declining steadily since 1983, while home price appreciation has remained extremely weak. Moreover, through the first half of 1986, mortgage interest rates have experienced the sharpest drop of the postwar era. Refinancing generally occurs if the drop in the mortgage market coupon falls sufficiently to cover the expense of refinancing over a period of three to seven years, depending upon the residency plans of the borrower. If there has been sufficient property appreciation, a loan previously requiring private insurance may no longer require insurance on the refinancing, leading to additional savings for the borrower.

Therefore, those areas of the country that have had greater than average price appreciation are also most likely to refinance and go off the books, leaving the MIs with higher risk loans. As a consequence of this adverse selection process, claim frequencies on seasoned portfolios should tend to rise. Graph 9 shows just such a trend. Using five percent down, conventional fixed-rate mortgages, the chart depicts claim frequencies over time for such loans grouped by year of origination. For all of the groups of loans originated during 1978-1980, claim frequencies peaked in 1983, declined in 1984, and then reached new peaks in 1985. All of the books from 1981 forward have yet to turn down. Alarmingly, the claim frequencies for both the 1981 and 1982 books of business worsened sharply in 1985 from 1984, because of the dual influence of refinancing and low price appreciation. The 1983 book, while better than 1981 and 1982, remains worse than the 1980 book. The 1984 book so far appears to resemble the 1979 book. The 1985 book, because of tighter underwriting standards, has had the best first-year performance in more than 14 years. □

MORTGAGE MARKET TRENDS

With data for December just starting to be made available, it appears that the annual rate of GNP growth for the fourth quarter might still come in at 3 percent or a little more. This would be only a modest increase from the third quarter pace of 2.8 percent, and is probably higher than we can expect for the first half of 1987. A portion of the fourth quarter's activity was driven by changes to the tax code that went into effect at year-end. This boost provided to fourth quarter output will weaken demand in 1987, especially in the early months of the year. Thus, there should be little if any upward pressure on interest rates through the middle of the year, and there is still a likelihood of another cut in the discount rate by mid-year.

Despite the fact that gains in the disposable personal income of consumers slowed in November, spending picked up modestly after a slip in October. Excluding autos, retail sales in November showed a rebound from October's sales pace. Auto sales slid further in November, but soared in December to their highest rate for that month since 1976. Even with the year-end surge, domestic auto sales in the fourth quarter will be below the financing-induced sales pace of the autumn months. This flurry of last-minute spending will, however, leave consumers with further reductions in their savings, and thus restrict their ability to increase their level of expenditures in the coming months of 1987.

Industrial production, following only slight growth in October, rose fairly strongly in November. Increases were widespread among the major categories of manufacturing output. New orders for durable goods excluding defense rose modestly further in November to a level above third quarter averages.

Although business fixed investment may post a modest fourth quarter increase, the outlook for further gains in this sector during 1987 is not good. Orders for non-defense capital goods rose by 6.4 percent in November, and this measure is currently running at a fourth quarter pace 1½ to 2 percent above the third quarter's. December's investment levels could be heavily affected by the change in year-end depreciation schedules, but with capacity utilization still below 80 percent in November, continued improvement into 1987 appears unlikely. In fact, the latest Commerce Department estimate now predicts a slight 0.2 percent increase in real spending by business for new plant and equipment in 1987 relative to 1986. Further, although construction of non-residential buildings remained at a relatively healthy pace in the fourth quarter, the negative impact of the new tax changes, plus the high current level of vacancy rates for commercial property, are expected to reduce activity in this sector of the economy during 1987.

Activity in the residential housing market, while off a bit from earlier levels, remains relatively healthy. Sales of existing homes reached an annual rate of 3.92 million units in November, the highest level since September 1979. New one-family home sales dipped in November, but single-unit housing starts nevertheless rose somewhat from October's level. Starts of multifamily structures, however, declined 5 percent in November, even as permits for further construction jumped 15 percent. This large jump in multifamily permits is probably only a reflection of stricter limits imposed by the new tax law on industrial development bond financing of multifamily construction. Thus, even with a continuation of the current mortgage rate climate, residential investment probably will not be a source of stimulus to economic activity in 1987.

Two important elements of the economic climate during 1987 will be affected by yet a third. Recent data on prices and wages have continued to be encouraging, which in turn have benefited interest rates. The decline in the value of the dollar, relative to foreign currencies, has yet to have a material impact on domestic prices. Increases in producer prices remained small in October and November, and actually registered no change in December. Consumer prices have risen moderately in recent months. However, at least a portion of this moderation in prices can be expected to dissipate if the newfound discipline among OPEC members is more than just a temporary phenomenon.

A surge in the U.S. trade deficit occurred in November, and the estimated deficit for October was revised upward. While the monthly trade figures can be quite erratic and subject to substantial revision, the November data were indeed unexpected, as many observers had thought that improvement was underway during the summer months. Nevertheless, some improvement in this sector is still expected during 1987.

With the economy likely to grow moderately in the first half of the year, the Fed may decide to take further easing actions early this year in the form of a cut in the discount rate. Recent developments, however, may have reduced somewhat the probability of additional aggressive moves towards ease by the Fed. The dollar has come under renewed downward pressure in international markets, and the Federal Reserve may be reluctant to put greater pressure on the dollar by lowering domestic interest rates. Also, the recent increase in world oil prices, together with the growing threat of protectionist measures, may add somewhat to inflationary pressures in 1987.

On balance, MBA economists think that modest further declines in interest rates are probable, including a reduction in conventional mortgage rates to a little below 9 percent by mid-year. A decline of this magnitude should allow single-family housing starts during 1987 to average around their current level of 1.2 million units, with the volume of mortgage originations remaining close to levels in the latter months of 1986.

Gregory D. Luetscher
Economist
January 12, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
JUN	184	132	52	1,852	1,310	542	173	121	52	1,792	1,229	563
JUL	172	122	50	1,782	1,218	564	165	115	50	1,759	1,196	563
AUG	164	117	47	1,795	1,275	520	144	100	44	1,673	1,147	526
SEP	154	108	46	1,664	1,161	503	152	103	49	1,603	1,144	459
OCT	155	109	46	1,628	1,171	457	145	103	43	1,565	1,109	456
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
11 MONTHS												
1986	1,693	1,185	508				1,624	1,101	523			
1985	1,621	1,094	527				1,606	1,010	596			
1984	1,616	1,093	523				1,575	1,005	570			
1983	1,595	1,112	483				1,497	970	527			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
JUN	30	35	70	48	283	300	768	501	28	30	66	50	274	286	728	504
JUL	28	34	64	45	270	336	705	471	30	31	61	43	314	297	692	457
AUG	34	30	60	40	321	293	707	474	25	28	52	39	272	289	653	459
SEP	29	27	61	37	280	270	702	412	30	28	53	41	297	258	597	451
OCT	27	28	60	41	250	238	678	462	27	27	52	40	260	249	598	458
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
11 MONTHS																
1986	275	276	693	449					264	272	634	454				
1985	235	227	726	435					242	220	690	453				
1984	190	232	815	413					186	200	760	430				
1983	159	207	873	357					153	179	806	360				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands) EXISTING HOUSES[1]	NEW HOMES Sold	NEW HOMES Available For Sale	NEW HOMES Months Supply at Current Rate	VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions) Seasonally Adjusted Annual Rate Total	1 Unit	2+ Units	Non-res.	CONSTRUCTION STATUS (Units in thousands) Seasonally Adjusted Annual Rate Under Construction Total	1-4 Units	5+ Units	Completions Total	1-4 Units	5+ Units
1986														
JUN	338	66	340	5.8	226.7	102.4	32.8	91.5	1,153	665	488	150	103	47
JUL	336	57	349	6.1	229.2	104.1	32.5	92.6	1,157	675	482	151	101	50
AUG	341	52	354	7.0	232.2	105.4	32.4	94.4	1,164	682	482	159	109	50
SEP	317	60	357	5.9	231.7	106.6	31.8	93.3	1,154	677	476	157	112	45
OCT	326	54	362	6.4	231.6	106.8	32.7	92.1	1,143	675	468	167	117	50
[illegible]														
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
11 MONTHS														
1986	3,299	698										1,580	1,086	494
1985	3,099	639										1,536	1,054	482
1984	2,694	601										1,503	1,034	469
1983	2,539	574										1,252	913	339

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL Total	TOTAL Mtg. Bankers[9]	TOTAL S&Ls	TOTAL Banks[2]	TOTAL Life Cos.	1-4 UNITS Total	1-4 UNITS Mtg. Bankers[9]	1-4 UNITS S&Ls	1-4 UNITS Banks[2]	1-4 UNITS Life Cos.
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY	50,363	12,534	18,630	16,485	2,714	38,365	11,821	15,793	10,497	254
[illegible]										
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
6 MONTHS										
1986	239,773	57,049	90,581	77,779	14,364	177,399	52,85[illegible]	73,356	49,840	1,348
1985	154,435	27,409	64,260	51,319	10,477	101,481	25,54[illegible]	48,224	27,322	391
1984	150,808	30,460	64,836	47,948	7,564	102,450	25,410	48,992	27,645	403
1983	126,145	33,860	44,644	41,714	5,927	89,407	28,390	35,322	25,338	357

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAY	2,578	489	1,363	508	218	9,420	224	1,474	5,480	2,242
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
6 MONTHS										
1986	13,009	2,676	7,843	2,975	1,515	49,365	1,518	9,382	26,964	11,501
1985	11,337	1,009	6,654	2,808	866	40,617	856	9,382	21,189	9,190
1984	11,829	1,830	6,427	2,861	711	36,529	3,220	9,417	17,442	6,450
1983	9,643	2,990	3,710	2,475	468	27,095	2,480	5,612	13,901	5,102

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JAN	$26,031	$7,695	$12,913	$3,000	$2,423	$ 96,650	$13,930	$47,353	$18,327	$17,040
FEB	31,132	7,954	13,907	6,680	2,591	108,898	16,153	44,355	30,732	17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR	47,297	12,715	21,823	8,751	4,008	137,435	27,712	53,917	35,033	20,773
MAY	61,486	9,883	23,380	22,858	5,365	160,521	24,409	56,406	56,531	23,175
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
6 MONTHS										
1986	259,843	65,568	112,989	59,193	22,093					
1985	144,552	23,236	78,155	28,305	14,856					
1984	141,883	27,390	77,593	25,650	11,250					
1983	126,101	43,390	56,024	18,114	8,573					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
JUN	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
JUL	320	166	42	112	153	10,878	64	3,971	27	1,942	62	4,965
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
OCT	249	128	38	83	162	11,293	75	4,556	28	2,024	59	4,713
1985 TOTAL	2,194	902	251	1,041	1,261	63,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
11 MONTHS												
1986	3,068	1,797	413	858	n.a.	n.a.	n.a.	n.a.	306	21,952	537	42,125
1985	2,031	822	229	980	1,168	76,986	315	18,425	173	11,699	680	46,862
1984	1,736	427	182	1,127	1,262	82,462	190	10,260	185	12,730	887	59,472
1983	1,830	721	314	795	1,198	71,876	356	18,093	263	16,518	579	37,265

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
JUN	3,049	3,000	72,377	6,831	9,720	10,338	10,505	10,353	9,472	8,178
JUL	3,270	3,343	76,197	6,106	8,585	7,863	8,518	8,118	14,246	10,226
AUG	3,840	3,800	81,060	7,079	12,722	13,707	10,458	10,127	10,177	6,813
SEP	4,248	4,649	86,359	7,357	10,943	10,658	12,485	13,090	36,333	12,861
OCT	2,375	3,784	89,573	5,535	n.a.	n.a.	n.a.	n.a.	9,859	10,221
1985 TOTAL	20,225	21,510	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
1984 TOTAL	21,007	16,721	—	13,546	30,743	32,601	21,885	20,489	36,101	27,857
11 MONTHS										
1986	31,716	28,491	—	55,073	89,264	81,524	70,740	68,911	142,534	86,046
1985	18,367	19,848	—	20,284	31,446	34,488	31,021	28,589	58,932	41,349
1984	18,249	14,759	—	12,254	20,359	21,606	12,642	11,590	32,849	25,787
1983	17,136	15,354	—	12,500	24,997	26,452	17,043	15,674	66,234	47,953

* FHLMC Year-to-date totals are for nine months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1986								
JUL	10.01%	10.28%	10.32%	10.30%	10.26%	8.29%	9.813%	12.02%
AUG	9.80	9.88	9.92	10.26	10.26	7.96	9.455	11.45
SEP	9.90	9.96	9.95	10.17	10.08	7.86	9.588	12.16
OCT	9.80	9.89	9.85	10.02	9.97	7.75	9.425	12.09
NOV	9.26	9.47	9.47	9.91	9.84	7.76	9.440	11.54

CURRENT SECONDARY MARKET YIELDS

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]
1986			
JUL	9.32%	9.48%	9.49%
AUG	9.11	9.20	9.23
SEP	9.28	9.25	9.30
OCT	9.05	9.12	9.16
NOV	8.78	8.91	8.94

SELECTED SECURITIES

YEAR AND MONTH	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986				
JUL	9.57%	7.30%	5.86%	6.33%
AUG	9.51	7.17	5.55	5.92
SEP	9.56	7.45	5.35	5.68
OCT	9.48	7.43	5.26	5.68
NOV	9.31	7.25	5.42	5.76

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
JUL	50	202	218	219
AUG	29	194	203	206
SEP	34	183	180	185
OCT	49	162	169	173
NOV	18	153	166	169

NA—Not available; p—Preliminary.

[1] From the National Association of Realtors "Existing Home Sales" series.

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

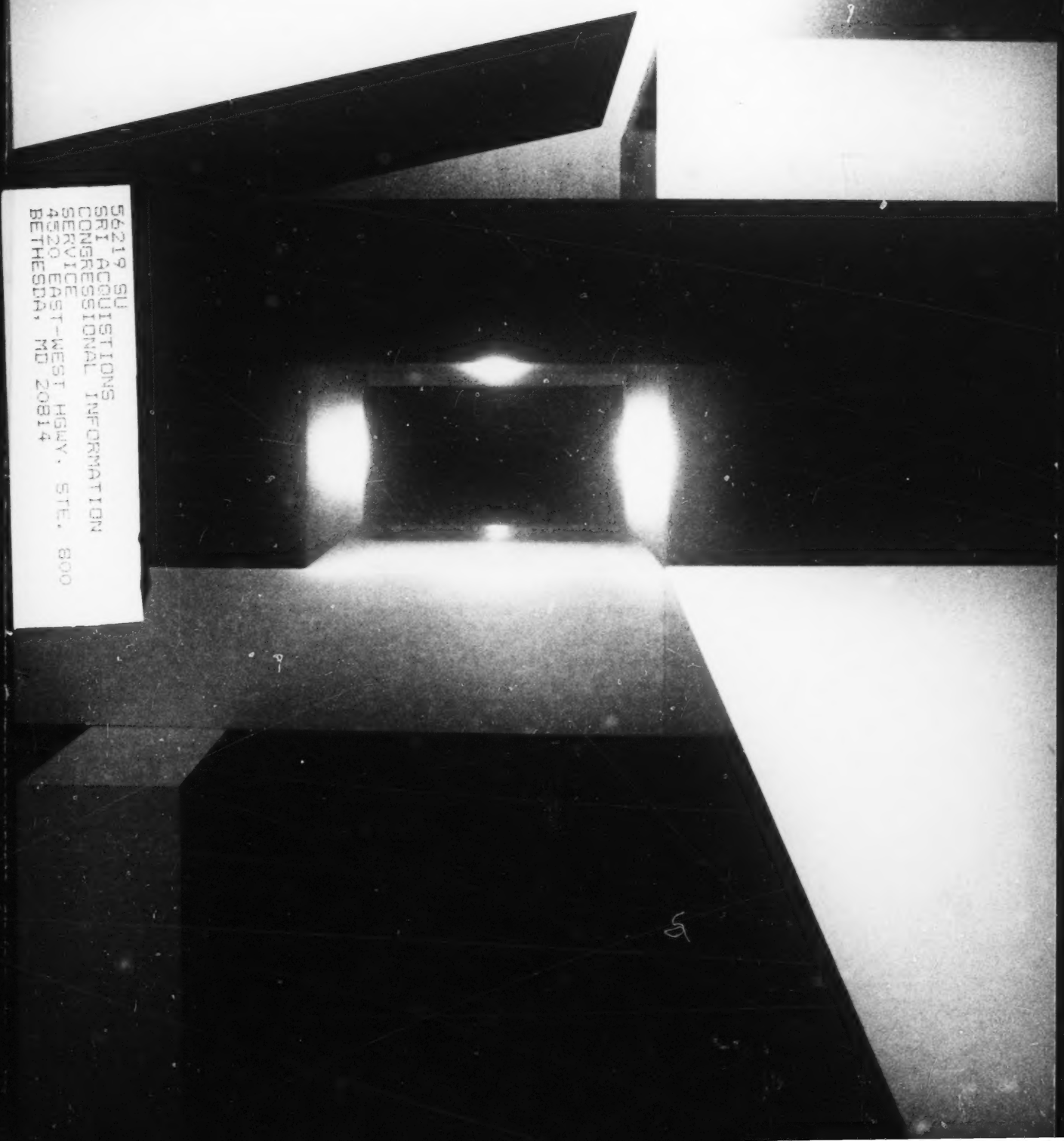
A6450-2
3/10/87

MORTGAGE BANKING

MARCH 1987

gazine
State Finance

EMICs



56219 SU
SRI ACQUISITIONS
CONGRESSIONAL INFORMATION
SERVICE
4520 EAST-WEST HGWY. STE. 800
BETHESDA, MD 20814

MORTGAGE BANKING

VOLUME 47 NO. 4
MARCH 1987

ARTICLES

PAGE 8
CAPITAL PREVIEW: GOING PUBLIC OR PRIVATE
Scott A. Shay
Mortgage banking is a capital intensive business today. Competitors that acquire sufficient capital from financially set parent companies or from public markets will take away market share from those without adequate capital. This Salomon Brothers' expert details ways in which a mortgage company can raise needed capital.

PAGE 24
WHAT DO REMICs MEAN TO YOU? UNDERSTANDING THE BUILDING BLOCKS
Donald B. Susswein
This article describes what REMICs are and how they will change mortgage-backed securities transactions. Several examples illustrate the author's explanations. You will need to know the building blocks to understand what REMICs will mean to the industry.

PAGE 35
HEDGING WITH FUTURES: NAVIGATING THE RAPIDS
Mark Pitts, Kay Willcox and Hasan Latif
Shearson Lehman Brothers presents its approach to hedging MBSs that models the prepayment option attached to mortgage loans.

PAGE 49
EXCESS SERVICING: THE RISKS AND THE REWARDS
Jonathan M. Prince and Val R. Bitton, CPA
Learn why lenders would sell lower pass-through rates to the secondary market and how lenders will account for such transactions in this article. The economics and accounting treatment for excess servicing are examined closely.

PAGE 62
CUSTOMIZED MORTGAGES: MORE THAN JUST PLAIN VANILLA
H. Beth Marcus
Today there are a variety of mortgage products available that cater to the differing tastes and needs of the consumer. The day may not be far away when a borrower will go to a lender and ask for a loan that meets exact requirements—payments, interest, rate of equity build-up and mortgage term, according to this author.

PAGE 75
FLOW SERVICING SALES: WHAT ARE THE ADVANTAGES?
Kenneth Cohen
This article explores the salient characteristics of flow servicing transactions, involving both government and conventional loans. Monthly sales of flow transactions offer significant advantages to both parties.

PAGE 85
SECONDARY MORTGAGE MARKET IN THE LAND DOWN UNDER
Prue Larocca
This articles describes the emerging secondary market in Australia. Interestingly enough, the Australian secondary market is sponsored by state governments rather than the federal government. Plans are underway to make the Australian secondary market similar to the U.S. secondary mortgage market.

PAGE 95
BUSINESS BASICS HOW TO HEDGE YOUR MORTGAGE PIPELINE
Calvin M. Watts
This article gives a basic description of different hedge strategies and identifies the risks involved.

DEPARTMENTS

ABOUT THE ISSUE	5
BUSINESS BASICS	95
PEOPLE	102
BOOKS	112
SECONDARY MORTGAGE MARKETS	115
MORTGAGE MARKET TRENDS	117
AD INDEX	126

Recent revisions in the 1986 November foreign trade figures should result in a revised figure for the fourth quarter's annualized growth rate of gross national product (GNP) of slightly more than 2 percent. A slowdown in the rate of growth of consumer spending, partially offset by increases in inventory investment and net exports, should lead to economic growth at a similar pace in the first half of 1987. Interest rates should remain at roughly current levels during this period, then trend upward somewhat in the second half of the year as the pace of economic activity improves moderately to the 3 percent range.

Early reports suggest that the economy is currently stronger than had been expected. Non-farm payroll employment registered a gain of 450,000 new jobs in January, compared with the monthly average of 260,000 of the fourth quarter. Even after taking into account that the January figure reflects some seasonal adjustment difficulties that magnify the gains in the construction and retail trade sectors, the increase was large enough to indicate that the economy started the new year with a good deal of momentum.

The rate of growth of consumer spending, which was 4 percent in 1986, should be somewhat weaker this year. In both 1985 and 1986, the rate of growth of personal consumption exceeded that of income by a significant amount. This resulted in rates of increase of consumer installment debt of 18 percent in 1985 and 11 percent in 1986, as well as a sharp decline in the personal saving rate. Consumers can now be expected to slow their consumption plans in order to pay down debt and replenish their savings. In addition, much of the spending initially planned for early 1987 was "moved up" to the second half of 1986 to take advantage of financing incentives and to avoid the loss of the sales tax deduction under the new tax law, which went into effect at the beginning of the year.

There are signs that the consumer is already retrenching. Real personal consumption expenditures declined in the fourth quarter. The rate of growth of installment credit fell to 0.2 percent in December. The Conference Board reports a sharp drop in consumer spending plans in January compared with December. Also, January 1987 automobile sales were extremely slow. However, the fact that major retail chains reported moderate sales growth in January indicates that the consumer spending might not be quite as weak as earlier anticipated.

Business investment in plant and equipment can be expected to remain relatively flat during the course of the year. Residential construction is expected to decline somewhat, with strength in the single-family sector being offset by further declines in the multifamily area, due largely to unfavorable changes in tax law and high vacancies.

There are indications that the recent strength in merchandise exports can be expected to intensify in the near term. The fall in the value of the dollar during the past two years finally seems to be taking effect on the export side. Anecdotal evidence indicates a substantial increase in business for firms engaged in the production of such exchange rate sensitive items as chemicals, drugs, lumber and paper products, computers and heavy machinery. This perception is reinforced by the recent strong performance of the securities of firms in these sectors on the stock market. In addition, the January Purchasing Managers Survey found that a significant portion of their observed increase in orders was attributed to export orders as well as to business that was switched to domestic suppliers.

The anticipated export gains should result in a steadily improving trade balance during the course of the year even though the volume of imports can also be expected to increase somewhat. This should add significant strength to the economy, especially in the second half.

Government spending is likely to show only sluggish growth in 1987 as the administration and Congress strive to comply with the spirit of Gramm-Rudman-Hollings.

Inflation is expected to return to its year-earlier level or somewhat higher now that the full effects of the fall in the price of oil have worked their way through the system. Indeed, oil prices have increased significantly during the past several months. In addition, increased prices for imported goods could lead to increases in some domestically produced goods as well. However, the rate of price increase should remain in the 3- to 4-percent range.

The unexpected strength in the current quarter implied by the recently released data sharply reduce the prospects of a lowering of the discount rate by the Federal Reserve in the near term. This is especially true in light of international monetary market considerations with respect to the dollar.

Continued moderate mortgage interest rates should result in another strong year in the single-family housing sector in 1987. Single-family starts should reach 1.25 million while origination volume approaches $350 million.

Victor Cholewicki
Economist
February 10, 1987

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
JUL	172	122	50	1,782	1,218	564	165	115	50	1,759	1,196	563
AUG	164	117	47	1,795	1,275	520	144	100	44	1,673	1,147	526
SEP	154	108	46	1,664	1,161	503	152	103	49	1,603	1,144	459
OCT	155	109	46	1,628	1,171	457	145	103	43	1,565	1,109	456
NOV	116	83	33	1,585	1,154	431	109	72	37	1,613	1,083	530
1986 TOTAL	1,807	1,263	544				1,759	1,183	576			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
12 MONTHS												
1986	1,807	1,263	544				1,759	1,183	576			
1985	1,742	1,166	576				1,734	1,077	657			
1984	1,750	1,206	544				1,682	1,065	617			
1983	1,703	1,181	522				1,605	1,035	570			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
JUL	28	34	64	45	270	336	705	471	30	31	61	43	314	297	691	457
AUG	34	30	60	40	321	293	707	474	25	28	52	39	272	289	653	459
SEP	29	27	61	37	280	270	702	412	30	28	53	41	297	258	597	451
OCT	27	27	60	40	256	236	682	454	27	27	52	40	260	249	598	458
NOV	22	20	43	31	272	244	591	478	19	21	41	29	260	287	605	461
1986 TOTAL	294	295	733	484					286	291	678	504				
1985 TOTAL	252	240	782	468					260	237	753	484				
12 MONTHS																
1986	294	295	733	484					286	291	678	504				
1985	252	240	782	468					260	237	753	484				
1984	204	243	866	436					201	212	812	457				
1983	168	218	935	382					164	188	863	390				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands) EXISTING HOUSES[1]	NEW HOMES Sold	NEW HOMES Available For Sale	NEW HOMES Months Supply at Current Rate	VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions) Seasonally Adjusted Annual Rate Total	1 Unit	2+ Units	Non-res.	CONSTRUCTION STATUS (Units in thousands) Seasonally Adjusted Annual Rate Under Construction Total	1-4 Units	5+ Units	Completions Total	1-4 Units	5+ Units
1986														
JUL	336	57	349	6.1	229.2	104.1	32.5	92.6	1,157	675	482	151	101	50
AUG	341	52	354	7.0	232.2	105.4	32.4	94.4	1,164	682	482	159	109	50
SEP	317	60	357	5.9	231.7	106.6	31.8	93.3	1,154	677	476	157	112	45
OCT	326	54	361	6.2	231.6	107.0	32.7	91.9	1,142	675	467	167	117	50
NOV	266	48	357	6.2	230.1	107.0	33.0	90.1	1,123	664	459	148	106	40
1986 TOTAL	3,565	749										1,755	1,205	550
1985 TOTAL	3,214	688										1,704	1,170	534
12 MONTHS														
1986	3,565	749										1,755	1,205	550
1985	3,214	688										1,704	1,170	534
1984	2,868	639										1,652	1,137	515
1983	2,719	623										1,390	1,016	374

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	1-4 UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
FEB	$28,203	$5,835	$10,478	$9,983	$1,907	$18,980	$5,326	$8,157	$5,418	$79
MAR	34,748	8,906	13,190	10,211	2,441	25,767	8,134	10,348	6,944	341
APR	43,754	10,037	15,811	15,490	2,416	31,838	9,443	12,705	9,375	315
MAY	50,363	12,534	18,630	16,485	2,714	38,365	11,821	15,793	10,497	254
JUN	59,859	14,251	21,960	20,140	3,508	45,093	12,963	18,460	13,465	205
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
7 MONTHS										
1986	302,492	73,583	112,268	98,724	17,917	224,749	68,715	91,995	62,200	1,839
1985	186,310	34,913	76,436	62,370	12,591	123,445	32,205	57,317	33,431	492
1984	175,871	33,330	77,815	55,992	8,734	123,189	31,187	59,205	32,322	475
1983	149,110	37,568	54,919	49,701	6,922	110,261	35,547	43,619	30,674	421

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
FEB	$2,335	$323	$1,099	$541	$372	$6,888	$186	$1,222	$4,024	$1,456
MAR	2,216	300	1,278	447	191	6,765	472	1,564	2,820	1,909
APR	2,478	404	1,305	416	353	9,438	190	1,801	5,699	1,748
MAY	2,578	489	1,363	508	218	9,420	224	1,474	5,480	2,242
JUN	3,615	1,076	1,580	631	328	11,151	212	1,920	6,044	2,975
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
7 MONTHS										
1986	18,042	3,140	9,188	3,572	2,142	59,701	1,728	11,085	32,952	13,936
1985	13,343	1,263	7,628	3,413	1,039	49,522	1,445	11,491	25,526	11,060
1984	12,039	348	7,390	3,514	787	40,643	1,795	11,220	20,156	7,472
1983	8,225	425	4,469	2,792	539	30,624	1,596	6,831	16,235	5,962

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
FEB	$31,132	$7,954	$13,907	$6,680	$2,591	$108,898	$16,153	$44,355	$30,732	$17,658
MAR	42,995	14,666	17,787	6,118	4,424	124,558	23,110	50,614	31,625	19,209
APR	47,297	12,715	21,823	8,751	4,008	137,435	27,712	53,917	35,033	20,773
MAY	61,486	9,883	23,380	22,858	5,365	160,521	24,409	56,406	56,531	23,175
JUN	49,263	12,655	23,179	10,147	3,282	151,008	32,922	56,520	39,347	22,219
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
7 MONTHS										
1986	305,135	75,998	136,090	68,407	24,640					
1985	173,371	29,942	92,749	33,241	17,439					
1984	162,382	29,098	91,017	29,886	12,381					
1983	146,079	43,645	70,116	21,581	10,737					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
JUL	320	166	42	112	153	$10,878	64	$3,971	27	$1,942	62	$4,965
AUG	265	128	44	93	191	13,197	95	5,840	37	2,657	59	4,700
SEP	274	141	51	82	191	13,095	82	4,805	48	3,467	61	4,823
OCT	249	128	38	83	162	11,293	75	4,556	28	2,024	59	4,713
NOV	201	101	38	62	n.a.	n.a.	n.a.	n.a.	32	2,257	47	3,776
1986 TOTAL	n.a.	n.a.	452	923	n.a.	n.a.	n.a.	n.a.	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
12 MONTHS												
1986	n.a.	n.a.	452	923	n.a.	n.a.	n.a.	n.a.	345	24,720	586	46,138
1985	2,193	902	251	1,040	1,261	83,306	338	19,784	193	13,047	730	50,475
1984	1,879	477	197	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
1983	1,993	777	333	883	1,307	79,470	367	19,141	286	17,966	654	42,363